United States Court of Appeals

for the Second Circuit

APPELLEE'S SUPPLEMENTAL BRIEF

75-7203

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

P/S

ROBERT ABRAHAMSON and
MARJORIE ABRAHAMSON,

Plaintiffs-Appellants,

vs.

MALCOLM K. FLESCHNER, WILLIAM J. BECKER,
HAROLD B. EHRLICH, LEON POMERANCE,
FLESCHNER BECKER ASSOCIATES, and
HARRY GOODKIN & COMPANY,

Defendants-Appellees.

SECOND SUPPLEMENTAL BRIEF
OF APPELLEES MALCOLM K. FLESCHNER,
WILLIAM J. BECKER, HAROLD B. EHRLICH
AND FLESCHNER BECKER ASSOCIATES

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May 13, 1977

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FOR THE SECOND CIRCUIT

NO. 212 - SEPTEMBER TERM, 1975

DOCKET NO. 75-7203

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ROBERT ABRAHAMSON and MARJORIE ABRAHAMSON,

Plaintiffs-Appellants,

v.

MALCOLM K. FLESCHNER, WILLIAM J. BECKER, HAROLD, B. EHRLICH, LEON POMERANCE, FLESCHNER BECKER ASSOCIATES and HARRY GOODKIN & COMPANY,

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SECOND SUPPLEMENTAL BRIEF
OF APPELLEES MALCOLM K. FLESCHNER
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AND FLESCHNER BECKER ASSOCIATES

This memorandum is submitted by defendants-appellees Fleschner, Becker, Ehrlich and Fleschner Becker Associates ("FBA") in accordance with the April 15, 1977 order of the Court granting their petition for rehearing on the issue of whether the general partners of FBA are "investment advisers" within the meaning of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-1, et seq. (the "Advisers Act").

Proper construction of the term "investment adviser," as defined by the Advisers Act, excludes the general partners of FBA:

(i) where FBA was a private, family-based investment partnership from which the "public" was excluded;

(ii) where the defendant general partners had invested the bulk of their assets in the partnership and where, in fact, the partnership itself was founded upon their funds and those of their families;

(iii) where the defendant general partners were not in the "business of advising others", including the limited partners, as to the value of or the advisability of purchasing or selling securities but were engaged only in the investment of the partnership's own assets, to which they had full legal title; and

(iv) where trial would show that FBA, in its history, composition, operation and investments, was fundamentally different from the "hedge funds" so broadly dealt with by the SEC in its brief and was, rather, as a family-based

investment partnership, virtually identical to the type of entity which the SEC has historically held not subject to the Advisers Act.

PROCEEDINGS BELOW AND STATE OF RECORD ON APPEAL

This appeal is taken from a final judgment entered in the Southern District of New York on March 4, 1975, granting defendants' motions for summary judgment pursuant to Fed. R. Civ. P. 56 and dismissing this action as to each of them on the ground that plaintiffs, who earned a net profit of over $289,000 on their $599,499.35 investment in FBA, suffered no damages compensable under law. The opinion below (Carter, J.) is reported at 392 F. Supp. 740 (S.D.N.Y. 1975).

Although plaintiffs cross-moved for summary judgment and submitted affidavits in support thereof, the record herein is directed primarily to the issue of plaintiff's lack of damages. Moreover, the findings of the Court below bear only on that issue.

FLESCHNER BECKER ASSOCIATES

A. Organization and Membership

FBA was organized on July 1, 1965 as The Fleschner Company with defendant Fleschner as the sole general partner and eight limited partners, including five members of the

Fleschner family, the two plaintiffs and one other close family friend (231a, 391a).*

The partnership, which had its office in the Fleschner home in Connecticut (32a, Fleschner Deposition at 3), was established as a family investment partnership for Fleschner and his family (171a), in which plaintiffs were permitted to participate, and had as its purpose the "investing and reinvesting in and holding stock, bonds and other securities and investments of every kind and character, including grain and other commodities . . ." (39a)

On April 1, 1966, defendant Becker, a friend and business associate of Fleschner, became a general partner bringing with him as limited partner 19 members of his family or trusts therefor and four members of the Rubinstein family, neighbors and close friends of the Beckers (82a-86a).** The

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* The Fleschner family limited partners were defendant Fleschner's wife (Janice Fleschner), his son (Andrew Fleschner), his sister (Rita Caine), his uncle (Charles Fleschner) and his niece (Susan Fleschner (Semel)). (Reference to "___a" are to the Joint Appendix.)

** Trial would show that in all 27 new limited partners were admitted on April 1, 1966; one was defendant Fleschner's niece, 14 were members of defendant Becker's family, 5 were trusts for various children in the Becker family group and 4 were attributable to the Rubinstein family. Thus, as of April 1, 1966, of the 35 limited partners, 24 were Fleschner or Becker family members or trusts and the balance were friends.

partnership name was changed to "Fleschner Becker Associates" and its office was moved to New York City (132a, 66a).

Trial would show that on October 1, 1966, eight additional limited partners were admitted to FBA, one from the Fleschner family and three from the Becker family,** three friends and one other interest, Prime Funding Company.**

On October 1, 1967, 17 limited partners were admitted to FBA, of whom 13 were members of the Fleschner or Becker families, one was FBA's controller and three were family friends.

Accordingly, as of the earliest dates when plaintiffs claim they would have withdrawn, i.e., the fiscal years ending September 30, 1967 or September 30, 1968, the composition of FBA was as follows:

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* At trial it would be shown that they were Fleschner's daughter, Laura B. Fleschner (Gschwanstner), Becker's brother-in-law, Morris Plapper, and his cousins Arthur and Laurence Morris.

** Later in the fiscal year ended September 30, 1967, Prime Funding instructed that its limited partnership interest was to be divided into 8 parts (hereafter the "Prime-Levitt" group): Prime Funding Co., the Custom Shop Park Avenue Corp., Custom Shop Dallas Corp., Custom Shop 55th Street Corp., 198-204 Main Street Corp., Elizabeth Levitt Trust, Peter Levitt Trust and Mortimer Levitt. The two Levitt trusts withdrew on September 30, 1967.

Partners and Their Investments In FBA,
By Group

	September 30, 1967		September 30, 1968	
	Partners	Capital(%)	Partners	Capital(%)
A. General Partners				
Fleschner and Becker	2 (4%)	14.53%	2 (3%)	14.42%
B. Limited Partners				
1. Fleschner and Becker Family Members	28 (56%)	42.06	41 (63%)	40.96
2. Prime-Levitt	8 (16%)	7.19	6 (9%)	5.59
3. Rubinsteins	3 (6%)	8.85	4 (6%)	8.04
4. Plaintiffs	2 (4%)	4.38	2 (3%)	5.54
5. Other Friends	9 (18%)	22.99	12 (18%)	25.47
TOTAL	50 (100%)	100.0%	65 (100%)	100.0%

On October 1, 1968, defendant Ehrlich joined FBA as a general partner, five new limited partners were admitted and 17 limited partners withdrew (106-08a). Four of the new limited partners, friends of defendant Ehrlich, contributed almost $8,000,000 in new capital. Thus, by reason of those large capital contributions, the capital accounts of the general partners and their families declined to 39.3% of total capital. The Fleschner and Becker families, nevertheless,

continued to comprise, numerically, more than half of the limited partners.*

B. Investments of FBA

Not only was FBA fundamentally different in its organization and composition from the "hedge funds" studied by the SEC in 1970, FBA's investments also were materially different in nature from those of the non-family funds. As a family-based investment entity, FBA's investment activities were substantially similar to traditional family entities, until now, never considered to be within the Act.

The record below partially describes FBA's investments, showing that between July 1, 1965 and September 30, 1970, a major portion of FBA's investments were debt obligations in the form of notes or convertible bonds (214a-218a, 286a). In connection with such investments, FBA frequently received unregistered common stock or warrants as an "equity kicker."** In most of its unregistered investments, FBA had the absolute right to request registration (248a). This

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* Annexed as Appendix A is a schedule showing the limited partners of FBA who were relatives of Fleschner or Becker.

** The alleged vice of "restricted" securities, upon which plaintiffs found their claims and upon which the SEC seems to encourage them, is no vice at all. Plaintiffs' capital was conserved by and was in fact increased as a result of FBA's investments in restricted securities.

method of investment afforded FBA the safety of debt investments and, at the same time, the potential for appreciation through ownership of equity.

In further contrast to the "hedge funds" referred to by plaintiffs and the SEC was the investment by the general partners of the bulk of their personal assets in the partnership. Unlike the hedge funds, FBA was a vehicle for personal investment in the partnership form for themselves, their families and friends. Members of the public were not solicited and, in fact, they were not permitted to join the partnership.

ARGUMENT

Persons who, like defendant general partners, manage private family investments in the partnership form involving a substantial portion of their personal assets have never been considered to be engaged in the "business of advising others" so as to render them "investment advisers" subject to the Advisers Act. Under partnership law, general partners of a limited partnership are vested with full title to the partnership estate, assume the risks of all liabilities of the partnership and are legally charged with the management of the partnership assets. As to the management of the partnership estate, the general partners cannot as a matter of law be construed as being "in the business of advising others".

The Court's original decision ignores both congressional intent not to regulate family investment activities, particularly those in the partnership form, and the SEC's own rulings, which have consistently interpreted "investment adviser" to exclude persons, like FBA's general partners, who (i) do not solicit funds of the public, (ii) do not hold themselves out to the general public as offering investment advice and (iii) limit their activities to managing private investment entities for themselves, their families and friends.

I

THE GENERAL PARTNER DEFENDANTS ARE NOT "INVESTMENT ADVISERS" AS THAT TERM WAS INTENDED BY CONGRESS

A. The Statutory Language

"The starting point in every case involving construction of a statute is the language itself." Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (Powell, J., concurring). Section 202(a)(11) defines the term "investment adviser" to mean, with certain exceptions,

> "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities; . . . ."

It is not, as plaintiffs assert, a "simple" or "plain" or "obvious" answer to conclude that, because the general partners were responsible for the investment of FBA's funds, they were just like professional investment advisers who manage individual investment accounts of the general public and therefore within this section.

FBA's general partners were plainly not in the "business of advising" the general public "as to the advisability of investing in, purchasing or selling securities." Nor under any proper construction can the general partners be regarded as having been "in the business of advising others" where they managed only the partnership estate to which they had full legal title, where they were charged in law with management of that estate, and where they assumed the full risk of the partnership liabilities.*

FBA was founded by Fleschner because he and his family recognized that one consolidated pool of investment capital would make available more investment opportunities than would be possible if each individual family member's capital were separately invested. Although non-family members were admitted to FBA, there is not the slightest suggestion in the record that FBA ever solicited funds from

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* Under New York law, the general partners of FBA held legal title to the partnership assets. The limited partners had no such title. N.Y. Partnership Law §§ 51, 98 (McKinney).

the public. The several non-family members, like plaintiffs, who were permitted to join the partnership, joined on their own initiative and were admitted because of their friendship with the general partners.

Finally, the fact that the limited partners received periodic reports from the partnership informing them of the partnership's affairs and its financial status does not support the conclusion that FBA's general partners were engaged in the "business of advising others . . . as to the advisability of investing in, purchasing or selling securities." To the contrary, the reports contained no recommendations or suggestions to the limited partners with respect to their participation in FBA.* Under such circumstances, it is thus frankly incredible to characterize these short "one page statements setting forth the percentage increase or decrease in the value of FBA's investments for the year to date" as "advice."**

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* The monthly reports no more constituted "advice" than did the annual financial reports which, for the years 1967 and 1968, unquestionably disclosed the extent of FBA's use of short selling and trading in put and call options (285-87a). Following that disclosure, plaintiffs nevertheless elected to remain limited partners despite the "conservative" investment objectives which they now profess.

** "Advice" is defined as a "recommendation regarding a decision or course of conduct." Webster's New International Dictionary, Unabridged (2d ed. 1960).

B. The Legislative History

Review of the legislative history of the Advisers Act, such as it is, makes clear that Congress and the SEC, when they referred to "investment advisers," considered them to be individuals or firms who, for a fee, were retained by members of the general public to render disinterested, impartial advice concerning investments. "Investment advisers" were assumed to have no substantial, personal stake in their advice and thus should have to meet certain minimum standards of trustworthiness. Nothing in the SEC reports or the congressional materials even hints that persons investing substantial amounts of their own money in partnership with their family and some friends were considered to be "investment advisers" to their partners.

Plaintiffs themselves concede that

> "We agree that the Congress' intentions were not so broad as to cast all persons who may conceivably have some responsibility for the investment of funds of others within the ambit of 'investment adviser.'" (Plaintiffs' Brief at 21).

That defendants are not investment advisers rests squarely on this critical difference -- between one who merely sells his thinking to the public (either in the form of advice or investment management) and one who, while investing substantial sums of his own money, privately takes in as partners members of his family and friends.

David Schenker, chief counsel for the SEC Investment Trust study,* prefaced his discussion of the proposed Advisers Act with a brief description of the category of individuals who were considered by the SEC to be "investment advisers":

> "The proposed bill also contains a short title relating to investment advisers, which encompasses that broad category ranging from people who are engaged in the profession of furnishing disinterested, impartial advice to a certain economic stratum of our population to the other extreme, individuals engaged in running tipster organizations, or sending through the mails stock market letters." Investment Trusts and Investment Companies: Hearings on S.3580 Before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess. (1940) (hereinafter "Senate Investment Hearings") at 47 (emphasis added).

To suggest, as do plaintiffs and the SEC, that the legislative history indicates that Congress intended to regulate family-based investment partnership such as FBA is simply ludicrous. Even the most cursory examination of the legislative history makes clear that there were no "exhaustive studies" or "extensive reports" made with respect to investment advisers prior to passage of the Advisers Act. It was the Investment Company Act which was carefully and thoroughly studied before its passage.

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* Securities and Exchange Commission, Investment Counsel, Investment Management, Investment Supervisory and Investment Advisory Services, H.R. Doc. No. 477, 76th Cong., 2d Sess. (1939).

Thus, the claim is unsupportable that comparably careful research and preparation preceded enactment of the Advisers Act. In fact, the chief counsel of the SEC Investment Trust Study, David Schenker, conceded that during the hearings that the SEC believed that its authority even to study investment advisers was very limited:

> "Now, this is fairly important: We did not obtain detailed information with respect to all 397 investment advisers that we found, for we were conscious of the limitation of our jurisdiction with respect to the scope of the investigation we could make. We felt we could only ask people who acted as investment managers to investment companies for detailed information.
>
> ". . . .
>
> "We made a detailed study of the investment companies. We expect in a few days to tell you what we found. But with respect to the investment counselors, we felt that our only jurisdiction was to get some information with respect to those investment counselors who are associated with investment companies." Senate Investment Company Hearings at 49, 51 (emphasis added).

As a result, only 70 of the 5,335 pages of reports submitted to Congress by the SEC concerned investment advisers,* and

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* Robert E. Healy, SEC Commissioner, submitted a compilation to the House Committee showing the number of pages in each report submitted to Congress in connection with the 1940 legislation. Investment Trusts and Investment Companies: Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce, 76th Cong., 3d Sess. (1940) (hereinafter "House Investment Company Hearings") at 307.

only 72 of the 1,276 pages of Congressional hearings related to the Advisers Act.* In the end, the Congress enacted as the Advisers Act the draft submitted by the industry.**

The Advisers Act, enacted as Title II of the bill in which the Investment Company Act was Title I, was viewed by the SEC as little more than a "compulsory census" of investment advisers, following which perhaps some further legislation would be considered.*** The Act was a way of gathering

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* The Advisers Act was discussed by only two witnesses in the House hearings. House Investment Company Hearings at 86-93.

In the Senate hearings, the testimony concerning the Advisers Act of Judge Healey, the SEC Commissioner who represented the Commission before the Congress, covers only four pages. Senate Investment Company Hearings at 318-21. Mr. Schenker testified for six pages, 47-51 and 1124, concerning Title II. The industry witnesses' testimony appears at 710-764.

** David Schenker, Chief Counsel of the Investment Trust Study for the SEC, testified at the conclusion of the Senate hearings:

> "In connection with the investment advisers, I think that Robert Page who represented Scudder, Stevens & Clark . . . submitted a draft of the bill to us, which is the draft that is included in this new bill." Senate Investment Company Hearings at 1124.

*** Mr. Schenker of the SEC testified as follows:

> "Therefore, our fundamental approach to this problem is in the first instance, before we could intelligently make an appraisal of the economic function or of the abuses

(Footnote continued on next page)

information and an effort to screen out the most obviously unqualified investment adviser. The Congress felt compelled to satisfy its "duty to protect the public" (id. at 753) from the "tipsters and touts" and "the other class" of advisers (id. at 748) and therefore passed a bill the basic goal of which was described during the hearings by Senator Wagner, committee chairman, as

> "a simple form of registration of some kind to the end that we do not put a man who is just out of jail in that work [investment adviser], of somebody who has been engaging in all kinds of practices and has been enjoined." Senate Investment Company Hearings at 746.

Even though Congress felt it had to do something, it nevertheless, because of the opposition from the investment counsel profession, significantly retreated on the issue of the registration requirement by reducing the amount of information which early drafts of the bill authorized the SEC

(Footnote continued from previous page)

> which might exist in that type of organization, to see if we could not get something which approximated a compulsory census. Fundamentally that is the basic approach of title 2. We first would like to find out how many people are engaged in this business, what their connections are, what is the extent of their authority, what is their background, who they are, and how they handle the people's funds." Senate Investment Company Hearings at 48 (emphasis added).

to require.*

Moreover, during the 37 years since its enactment, Congress has had before it numerous proposals to amend the Advisers Act (including one proposal which, in addition to amending the Act, would have required the SEC to study the scope of the term "investment adviser"**). At no time, however, has Congress taken any action to amend the definition of "investment adviser" and thus the scope of that definition must continue to be construed in light of Congressional intent when it defined "investment adviser" in 1940. It is not a "technical" or "restrictive" construction which defendants

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* The Commission lost in the final bill authority to request, inter alia,

> "copies of every form of contract or agreement between such investment adviser and its clients which is regularly used by such investment adviser . . . ." Senate Comm. on Banking and Currency, 76th Cong., 3d Sess., Committee Print of S. _____ at 99-100 (March 12, 1940).

Eliminated also was a section authorizing the SEC to request "such further information and copies of such further documents relating to such investment adviser" as the SEC judged necessary to protect the public. Id. Instead, the SEC's authority to request information was limited to choosing from a prescribed list of subjects explicitly set out in Section 203(c).

** That bill, H.R. 13737, was reported out by the House Subcommittee on Consumer Protection and Finance on May 12, 1976. The 94th Congress took no action on the bill, which has been reintroduced as H.R. 2105 in the 95th Congress. (Copies of h.R. 13737 and H.R. 2105 are annexed to the defendants' Petition For Rehearing.) The SEC has apparently withdrawn support for the bill.

urge but rather one which recognizes the basic purpose of the Act -- to protect the public from the unfortunate consequences of disinterested "advice" rendered by frauds, touts and reckless, uninvolved individuals.

To argue against this extremely modest legislative background that men engaged as partners in the common investment of their pooled assets fall within either the contemplation of Congress, or the scope of even the generally worded definition of "investment adviser", is simply assigning the legislative history more baggage than it can possibly carry.

II

THE SEC'S OWN PRIOR INTERPRETATIONS OF THE ADVISERS ACT ESTABLISH THAT GENERAL PARTNER DEFENDANTS ARE NOT "INVESTMENT ADVISERS"

The position taken by the SEC staff in its brief stands in stark contrast to the rulings of the full Commission on four separate occasions, two of which were handed down shortly after the Act's passage. On each occasion the SEC ruled that persons performing functions similar to those of the general partner defendants are "not within the intent" of the Act's definition of "investment adviser." The rulings identified those factors which, if present, require exclusion:

(1) the person, rather than being engaged in the mere selling of arms-length disinterested advice to the general public, is intimately involved in the outcome of his investment decisions, either by virtue of his own substantial investments, or as a result of strict fiduciary obligations which devolve upon him by virtue of his position, or both;

(2) the person did not solicit the participation of other investors; and

(3) the person administered a private investment entity in which participation was limited to his family and friends.

The SEC staff's brief attempts to dismiss these rulings of the full Commission as "not of precedential effect" (SEC Brief at 11), or, apparently arguing in the alternative, that they are "nearly or over three decades old" (id. at 13).

In the Matter of Loring, Investment Adviser Act Release No. 33, (July 22, 1942), 11 S.E.C. 885, [1941-1942 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 75,299, established the principle which defendants urge as the heart of their argument -- that the Advisers Act does not reach those who have a real and substantial personal stake in their investment decisions. Much of the Commission's discussion of

Loring's activities focuses precisely on his possessing legal title, or legal interest akin to title, of the property which, as trustee, he managed:

> "Applicant administers both personal property and real property. Where applicant acts with regard to personal property as trustee, executor, or administrator under court appointment, he holds legal title to the property and acts as principal. When applicant acts as guardian or conservator under court appointment, securities and bank accounts are also carried in his name as such although he may not have legal title. Applicant's services under these appointments are not limited to supervision of investments but include all other services ordinarily incident to the ownership and management of property. * * * Likewise, when applicant acts with regard to real property whether under court appointment or under an indenture, he acts as principal. Title to the real property is in his name, and his duties include all services ordinarily incident to ownership and management of such property. Where the applicant acts under power of attorney, he has full control over the property in question and performs duties substantially similar to those performed as trustee. It is important to note that applicant's activities under the powers of attorney constitute only a minor part of his business and are, in effect, incidental to his business of acting as trustee." (Emphasis added)

The briefs of both the SEC staff and the plaintiffs overlook the fact that the Loring exemption was granted by a Commission which included Commissioner Healy, the commissioner who had overall supervision of the SEC's Study of Investment Trusts and Investment Companies and who testified at length before Congress during its deliberations on the Investment

Company and Investment Advisers Acts. House Investment Hearings at 52.

The SEC's ruling in Loring was followed in Selzer v. Bank of Bermuda Ltd., 385 F. Supp. 415 (S.D.N.Y. 1974). There, the Court held that where an individual "acts himself as principal" he is not "advising others" and does not come within Section 202(a)(11):

> "A trustee is historically the legal owner of the trust corpus, while the beneficiary is the equitable owner. The trustee does not advise the trust corpus, which then takes action pursuant to his advice; rather the trustee acts himself as principal. While there may be public policy reasons for holding a trustee who deals in securities for its trust to the standards of the Investment Advisers Act, neither the common sense meaning of the word "adviser" nor a comparison with other situations to which the 1940 Act has been held applicable militates in favor of doing so." 385 F. Supp. at 420 (emphasis added).

In reaching its decision, the District Court considered and rejected a staff opinion much touted and twice cited and discussed in plaintiff's brief, Brewer-Burner & Associates, Inc., [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,719 (1974). The District Court to follow, not "the opinion of an S.E.C. staff division", but "a much earlier opinion by the Commission itself," 385 F. Supp. at 420, apparently believing it to be "of precedential effect."

The FBA general partners here, as in Loring, "acted as principals" with respect to the partnership assets,

to which they held full legal title. Thus, the instant case presents an even stronger basis in law for exclusion from the Advisers Act than did Loring and Selzer. Unlike Loring and Selzer, where trustees were excluded from application of Section 202(a)(11) for merely holding bare legal title to the assets they invested, the general partner defendants, in addition to possessing full legal title of FBA's assets, had each committed a substantial portion of their personal wealth to the investment partnership they managed.

The other early SEC ruling, in which Commissioner Healy also participated, is In the Matter of Donner Estates, Inc., Investment Advisers Act Release No. 21 (November 3, 1941), 10 S.E.C. 400, [1941-1944 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 75,216. Donner, which is cited by neither the SEC nor the plaintiffs, exempted a corporation which was owned by and advised 34 trusts created for members of the same family, and which in addition also advised a non-family trust created for a former employee of Mr. Donner, a charitable trust, and a charitable corporation. The Commission's opinion and order makes clear that its decision turned on the non-public, family nature of the Donner corporation.

The SEC's ruling in Donner was reaffirmed by the subsequent ruling of the SEC in The Matter of the Pitcairn Company, Investment Advisers Act Release No. 52 (March 7,

1949), 29 S.E.C. 186, [1948-1952 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 75,990. In Pitcairn, the SEC excluded The Pitcairn Company from the application of the Advisers Act because of the non-public, family nature of the applicant and because it, like FBA, never solicited anyone to employ its services.

The last of the four Commission exemptions, In the Matter of Roosevelt & Son, Investment Advisers Act Release No. 54, 29 S.E.C. 879, [1948-1952 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,016 (1949), is the most directly applicable to this case. The exemption there appears to have resulted from two characteristics of Roosevelt & Son shared by FBA: the generally non-public, family nature of the business of the applicant, a general partnership, and, of more importance, the fact that the firms' accounts were being converted to trusts, to which the general partners would serve as trustees or co-trustees with others and would therefore act as principals with respect to investments. A substantial number of the limited partners in FBA were family trusts. The SEC found it to be noteworthy that the trust agreement in Roosevelt, like the FBA partnership agreement,

> "does not appear to contain any provisions that would relieve the trustees of liability for malfeasance, bad faith, negligence, or disregard of the duties and obligations involved in the conduct of the trusts." Id. at 78,518.

Roosevelt is directly applicable to the instant case. The investment vehicles in both cases were essentially private, family partnerships with fundamentally the same ratio of family (2/3) and non-family (1/3) investors. In both cases, the managing general partners had their personal assets invested in the partnerships, and they did not solicit new investors.

These rulings of the Commission unquestionably demonstrate that the Act, in its use of the words "advising others," does not and was not intended by the Congress or the SEC to include the activities of individuals who are not engaged in selling disinterested, arms-length advice to the general public, but who instead are intimately involved in the outcome of their investment decisions, either by virtue of their own substantial investments (e.g., the FBA general partners) or as a result of strict fiduciary obligations which devolve upon them by virtue of their position (e.g., trustees). The general partner defendants, who possess both characteristics, are thus even further removed from the Act's intent.

These decisions also underscore that where the private aspects of an entity predominate, such that its activities are not intended for and do not in fact affect the general public, the entity is not within the intent of Section 202(a)(11). FBA which had, at one time or another, 55

limited partners* from the families of Fleschner or Becker, thus cannot be held to be within the intent of Congress when it defined "investment adviser."

Furthermore, the SEC continues to follow this conclusion by its own administrative practice. Conceding that it has been "aware of the existence of hedge funds" (SEC Brief at 16), the SEC has never undertaken to enforce the registration of hedge funds as "investment advisers" pursuant to Sections 203 and 214 of the Advisers Act. This, and the rulings of the full Commission discussed above, speak more forcefully than the several SEC staff opinions and no-action letters cited by the SEC and plaintiffs.** Moreover, these staff opinions are in direct conflict with rulings of the full Commission, which are of substantially greater authority. See Selzer v. Bank of Bermuda Ltd., supra, 385 F. Supp. at 420.

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* Including trusts.

** To the extent that these recent opinions of the SEC staff differ from the principles expressed by the four rulings of the full Commission discussed above, defendants submit that they are in error and should not be followed by the Court. William Ryan, [1971-72 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,102 (1971); Rami Hofshi, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,441 (1973); Brewer-Burner Associates, Inc., [1973-74 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,719 (1974); Brian A. Pecker, [1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,997 (1974).

Finally, the briefs of the SEC staff and the plaintiffs both conspicuously omit to refer to the opinion of the SEC Division of Trading and Markets in Gardner and Preston Moss, Inc., [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,638 (1972). There, the staff issued a no-action letter stating that it would not object to the non-registration as investment advisers of the general partners of a limited partnership formed to invest in venture capital situations. The failure of the SEC staff and plaintiffs to cite Gardner and Preston Moss is understandable -- FBA and the partnership there described share many of the characteristics which their briefs contend "compel" federal regulation. The partnership in Gardner had the following characteristics:

1) it was a "private, limited partnership;"

2) it had a limited number (more than 14 but fewer than 100) of sophisticated investors as limited partners (unlike FBA, the limited partners were to be solicited);

3) its general partners were to receive as compensation a percentage of the partnership's capital gains;

4) it would invest in unregistered stock pursuant to "private placement agreements";

5) its general partners would be exposed to unlimited liability as guarantors of any liability of the partnership in excess of its assets; and

6) the general partners initially screened all investment opportunities and, following a "final recommendation" by an outside adviser, made the "final decision" whether to invest on behalf of the partnership.

The only rationale advanced by plaintiffs and the SEC in their effort to obtain in this Court an unprecedented extension of the definition of "investment adviser" is the need to fill some purported "gap" in the regulatory scheme established by Congress in the Company Act and the Advisers Act.* But this rationale for expanding the scope of the federal securities laws has been consistently and forcefully rejected by the Supreme Court. Piper v. Chris-Craft Industries, Inc., [1976-77 Transfer Binder] Fed. Sec. L. Rep.

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* In an attempt to dismiss the persuasive authorities cited by the FBA general partners, plaintiffs argue that if they are "correct that the general partners of investment partnerships were not intended to be covered by the Advisers Act, an enormous gap in regulation would result" (Plaintiffs' Brief at 30). The SEC supports its position by arguing that "there is no reason why a manager of his own 'privately-held business operating in the partnership form' cannot also be an investment adviser" (SEC Brief at 7).

(CCH) ¶ 95,864 (1977) and Santa Fe Industries, Inc. v. Green, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,914 (1977).

The relationship between the general partners and the limited partners of FBA are governed by state law, and the plaintiffs are protected against any fraud or misconduct allegedly committed by the general partners.* Thus, "[a]bsent a clear indication of congressional intent," courts should not expand federal statutes so as to encroach upon areas traditionally left to state law. Santa Fe Industries, Inc. v. Green, supra, at 91,454.

III

IN THE ALTERNATIVE, DEFENDANTS ARE ENTITLED TO A REMAND TO THE DISTRICT COURT FOR ADDITIONAL FINDINGS OF FACT

Even on the basis of the limited record on appeal, the Court can properly conclude that the defendant general partners are not "investment advisers" within Section 202(a)(11) of the Advisers Act.

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* Under New York law, a general partner is a fiduciary to limited partners. Riviera Congress Assoc. v. Yassky, 18 N.Y.2d 540, 277 N.Y.S.2d 836 (1966). Limited partners have a personal cause of action against general partners for fraud or misconduct. Millard v. Newmark, 24 A.D.2d 333, 266 N.Y.S.2d 254 (1st Dept. 1966); N.Y. Partnership Law (McKinney) § 115-a.

If the Court is unable to make such determination, defendants are entitled to remand for the development of a complete record on this issue. What plaintiffs attempt is to persuade this Court to award them summary judgment on the issue, by-passing established procedures such as Rule 9(g) Statements which help to eliminate disputed factual issues. The Court should not resolve the critical and far-reaching Advisers Act issue on the basis of the naked assertions and unsupported allegations contained in plaintiffs' brief. As the District Court noted in its opinion below

> "summary judgment is not generally favored in this Circuit, and is sparingly granted in complicated securities cases, see, e.g., Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir. 1968) (en banc), cert. denied, 395 U.S. 906 (1969)."

CONCLUSION

Plaintiffs argue that the substantial investments of the general partners and their families in FBA provided, "at best," "moderate assurances" that they would not "gamble," play a "high-stakes game," take "foolish chances," or "squander" partnership funds. Plaintiffs neglect to state that not only was their capital conserved and returned to them intact, but that they also received a handsome $289,178.35 profit.

Plaintiffs also omit, in their newfound fear of the investment partnership device which they embraced so

happily during the bull market, that as partners in FBA they secured

> "substantial tax benefits, limited liability for partnership debts, and a share in partnership profits without having to participate in the operation of the partnership." Note, Procedures and Remedies In Limited Partners' Suits for Breach of the General Partners' Fiduciary Duty, 90 Harv. L. Rev. 763 (1977).

They forget that they deliberately entered into a partnership that was unquestionably empowered to operate in the most speculateive manner (Slip. op. at 6253; Gurfein, J., dissenting).

Plaintiffs have now been in federal court for over six years in their efforts to enhance their huge profit. Defendants submit that, for the foregoing reasons, plaintiffs should profit no more.

May 13, 1977

Respectfully submitted,

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APPENDIX A

Beneficial owners of Limited Partnership interests in FBA from Fleschner or Becker Families

FAMILY OF MALCOLM K. FLESCHNER

Abby Caine	-	niece
Rita Caine	-	sister
Alan Fleschner	-	nephew
Andrew K. Fleschner	-	son
Cecil Fleschner	-	brother
Charles Fleschner	-	uncle
Janice Fleschner	-	wife
Laura Fleschner Gschwanstner	-	daughter
Edmond Semel	-	nephew
Susan Semel	-	niece

FAMILY OF WILLIAM J. BECKER

Barbara Becker	-	sister-in-law
Frederic Becker	-	brother
James Becker	-	son
Laurie Becker	-	daughter
Marjorie Becker	-	wife
Martin Becker	-	nephew
Mary Becker	-	mother
Max Becker	-	father
Richard Becker	-	nephew
Robert Becker	-	son
Wendy Becker	-	daughter
Daniel Colburn	-	uncle
Iva S. Goldberg	-	aunt
Marlene Lupin	-	cousin
Rhonda Lupin	-	cousin
Abraham J. Morris	-	father-in-law
Arthur Morris	-	cousin
Barbara Morris	-	sister-in-law
Dara L. Morris	-	niece
Doris Morris	-	mother-in-law
Eric Morris	-	cousin
Jeanne Morris	-	niece
Jeffrey Morris	-	cousin
Jonathon Scott Morris	-	nephew

Judith Morris	-	cousin
Keith Morris	-	cousin
Kimberley Morris	-	niece
Laurence Morris	-	cousin
Max Morris	-	uncle
Mollie Morris	-	aunt
Nicole Morris	-	niece
Robert H. Morris	-	brother-in-law
Robin Morris	-	cousin
Morris Plapler	-	brother-in-law
Arthur Sonnenblick	-	brother-in-law
Michael Sonnenblick	-	nephew
Ruth Sonnenblick	-	brother-in-law's mother
Susan Sonnenblick	-	sister-in-law

CERTIFICATE OF SERVICE

GEORGE A. SCHOLZE, being duly sworn, deposes and says that he is an attorney associated with Sullivan & Cromwell, attorneys for Malcolm K. Fleschner, William J. Becker, FBA Associates, that on the 13th day of May, 1977 he caused the within brief to be served upon the following attorneys at the following addresses by having two true copies of the same delivered to each of the said attorneys at said addresses, by leaving the same with a person in charge of each of the said offices as follows:

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